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A smarter approach to cost reduction in the public sector

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Most cost-cutting programs fail. To do better for less, governments need to build capabilities, harness data and analytics, and reinvest savings.

The demands on governments are greater than ever, yet many countries face tough constraints on public spending. Worldwide, total gross government debt increased from $51 trillion in 2010 to $65 trillion in 2016 (in real 2010 prices). Several of the world's major economies now have debt-to-GDP ratios approaching or exceeding 100 percent and fiscal deficits of 4 percent or higher, according to data from the International Monetary Fund.

In response, many governments have initiated cost cutting on a large scale. A new survey conducted by the McKinsey Center for Government gauged the experience of nearly 3,000 public servants in 18 countries that together account for 75 percent of global GDP. The respondents included officials in national, regional, and local governments as well as state-owned enterprises. The survey found that 43 percent of all public-sector transformation efforts over the past five years have had cost reduction as a core goal.

Cost cutting was one of the most frequently cited goals of transformation programs in the countries covered in our survey (Exhibit 1). One in ten transformation efforts had the sole focus of reducing costs, while one in three combined cost cutting with improvement goals, such as boosting outcomes and improving the pace and quality of service delivery.
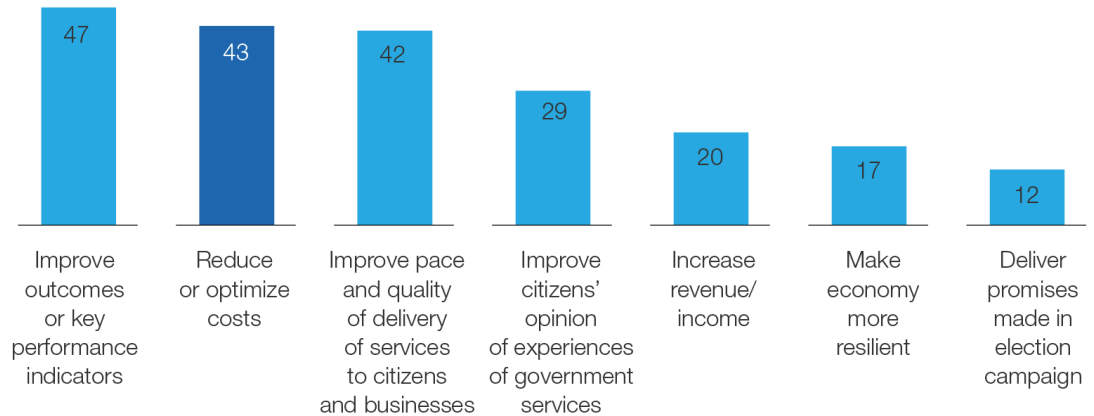
The problem is that most of these cost-reduction efforts fail. Of all the cost-driven transformation programs by governments covered in our survey, only 19 percent were "very or completely successful" in meeting their goals, by the respondents' assessment.

What explains this dismal record? One explanation is that many change leaders are using the wrong approach to cost cutting. Our survey found that governments that make big budget cuts simply to "force" efficiency improvements are less likely to deliver and sustain the intended cost reductions. That might seem counterintuitive, but the numbers bear out this finding. Among all the cost-reduction efforts we surveyed, those that used direct budget cuts were 15 percent less likely to be successful (as assessed by respondents) than those that did not. Of all the

Exhibit 1

Reducing or optimizing costs is frequently a key objective for
public-sector transformation efforts.

Share of transformation efforts that included objective,[1] %

47	43	42	29	20	17	12
Improve outcomes or key performance indicators	Reduce or optimize costs	Improve pace and quality of delivery of services to citizens and businesses	Improve citizens' opinion of experiences of government services	Increase revenue/ income	Make economy more resilient	Deliver promises made in election campaign

[1]As reported by respondents. Respondents weighted by GDP share of their country; unweighted total number of
respondents = 2,909.

Source: McKinsey Center for Government survey on public-sector transformations, December 2017

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government-transformation levers we examined in our survey, budget cuts were among those
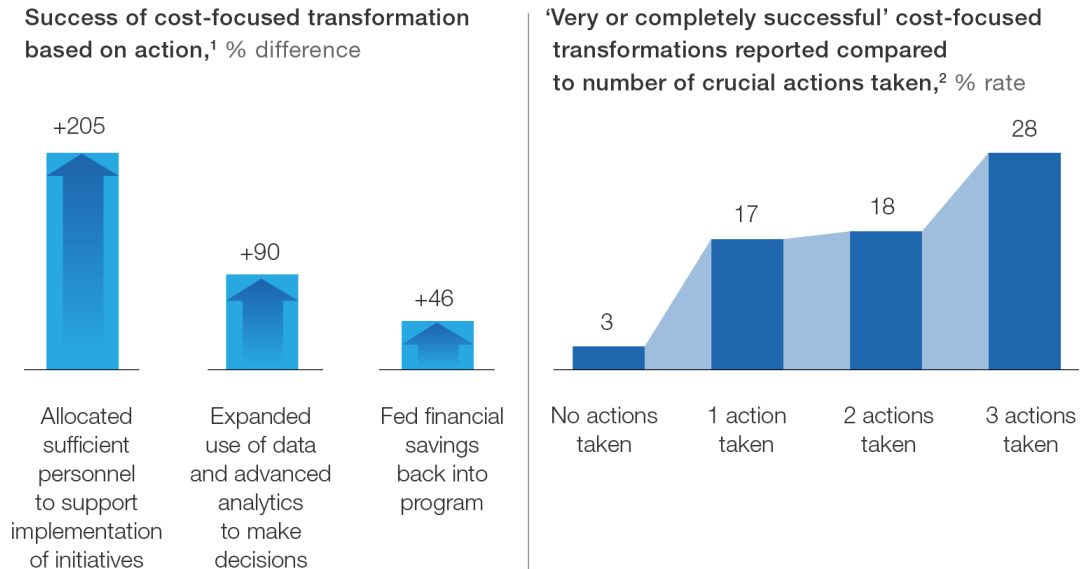that had the highest correlation with change-effort failure.

That is not to say that budget cuts never work: some respondents to our survey did report
instances in which direct cost reductions led to sustained improvements. As our survey findings
make clear, however, such successes are the exception rather than the rule. If governments
want to make sustained headway in containing costs, they need to look beyond budget cuts to
a much broader, more sophisticated tool kit.

As our recent research on government productivity highlighted, the tools available in a cost-
reduction effort include spending reviews, procurement optimization, and digitization. Our
survey findings point to three additional, crucial actions that can double or triple the success
rate of government transformation programs that involve cost reduction (Exhibit 2). When used
in combination, these tools have an even greater positive impact on outcomes.

The first action is allocating sufficient personnel to implement the change. Our survey shows
that this is one of the most critical success factors in any cost-reduction program. Among "very
or completely successful" cost-focused transformations, 92 percent had sufficient personnel
staffed. That was true for only 50 percent of "unsuccessful" cost-reduction efforts. This is
unmistakable evidence that change efforts—even those aimed at saving costs—should not
lack resources.

Exhibit 2

Transformations aimed at cost reductions can boost success by using a more sophisticated approach to data analysis and resource allocation.

Success of cost-focused transformation based on action,[1] % difference

+205 — Allocated sufficient personnel to support implementation of initiatives

+90 — Expanded use of data and advanced analytics to make decisions

+46 — Fed financial savings back into program

'Very or completely successful' cost-focused transformations reported compared to number of crucial actions taken,[2] % rate

3 — No actions taken

17 — 1 action taken

18 — 2 actions taken

28 — 3 actions taken

[1]Difference of transformations that included action vs those not including action being reported as "very or completely successful," as reported by respondents involved in cost-focused transformations. Respondents weighted by GDP share of their country; unweighted total number of respondents = 2,909.
[2]Crucial actions defined as allocated sufficient personnel to support implementations of initiatives, fed financial savings back into program, and expanded use of data and advanced analytics to make decisions.

Source: McKinsey Center for Government survey on public-sector transformations, December 2017

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The second action is using financial savings from change initiatives to fund further reforms. Cost-focused transformations that used this approach were 46 percent more likely to succeed than were those that did not. Using savings to fund further improvements—for example, in infrastructure, services for citizens, and civil servants' capabilities—appears to create a more meaningful purpose for cost-reduction efforts and to boost the motivation of the staff implementing the changes. This approach, however, might require governments to change their budgeting processes and decision-making time frames to enable ministries and agencies to "invest to save."

The third action is using data and advanced analytics, which points to a new horizon in effectively managing public finances. Cost-focused transformations that harness data and analytics to target their efforts are nearly twice as likely to succeed as those that do not, as shown by plenty of case studies. For example, one large public-sector agency we worked with used advanced analytics to optimize its fleet of 7,000 vehicles. It reduced costs by $10 million a year (or 20 percent), in part by cutting the use of short-term car rentals by 70 percent.

As analytics advances, governments can harness data to shape smarter cost-saving initiatives. For example, our analysis of primary- and secondary-education budgets in 33 countries

found that spending per student increased by an average of around 30 percent in real terms from 2005 to 2015; it is questionable whether such increases are sustainable in the future. McKinsey's extensive analysis of data from the Program for International Student Assessment has pinpointed opportunities to achieve savings while improving education outcomes. For instance, technology in the classroom—often a significant expense item—yields dramatically different student outcomes depending on the equipment used. In one region we studied, giving a single computer to a teacher raised student test scores six times as much as giving every student in the class a computer. In another region, installing a data projector in each classroom had twice as much impact on test scores as giving students computers.

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Governments the world over must urgently find ways to do more—and better—for less. Before embarking on large-scale cost cutting, however, they should take a sober look at the success rates of such programs. There are smart ways to ensure that cost-reduction efforts not only achieve their targets but also support better outcomes for citizens. It is time for governments to harness the full strategic and technological tool kit to target savings better and use the released funds to shape a more effective, responsive public sector. □

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